

**Before The  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554**

In the Matter of	)	
	)	
Implementation of Section 11 of the Cable	)	CS Docket No. 98-82
Television Consumer Protection and Competition	)	
Act of 1992	)	
	)	
Implementation of Cable Act Reform Provisions	)	CS Docket No. 96-85
of the Telecommunications Act of 1996	)	
	)	
The Commission's Cable Horizontal and Vertical	)	MM Docket No. 92-264
Ownership Limits and Attribution Rules	)	
	)	
Review of the Commission's Regulations	)	MM Docket No. 94-150
Governing Attribution Of Broadcast and	)	
Cable/MDS Interests	)	
	)	
Review of the Commission's Regulations and	)	MM Docket No. 92-51
Policies Affecting Investment In the Broadcast	)	
Industry	)	
	)	
Reexamination of the Commission's Cross-	)	MM Docket No. 87-154
Interest Policy	)	

**COMMENTS OF AT&T CORP.**

Douglas Garrett  
James H. Bolin, Jr.  
AT&T Broadband  
188 Inverness Drive West  
Englewood, CO 80112  
(303) 858-3510

Michael H. Hammer  
Francis M. Buono  
Willkie Farr & Gallagher  
Three Lafayette Centre  
1155 21st Street, N.W.  
Suite 600  
Washington, D.C. 20036-3384  
(202) 328-8000

Mark C. Rosenblum  
Stephen C. Garavito  
AT&T Corp.  
295 N. Maple Avenue  
Room 1131M1  
Basking Ridge, NJ 07920  
(908) 221-8100

David Carpenter  
David L. Lawson  
C. Frederick Beckner III  
Sidley Austin Brown & Wood LLP  
1501 K Street, N.W.  
Washington, D.C. 20005  
(202) 736-8000

*Counsel for AT&T*

January 4, 2002

## TABLE OF CONTENTS

	Page
INTRODUCTION AND SUMMARY.....	1
ARGUMENT.....	4
I. UNDER THE APPLICABLE LEGAL FRAMEWORK, SUBSCRIBER LIMITS CAN BE IMPOSED ONLY IF, AND ONLY TO THE EXTENT THAT, RECORD EVIDENCE DEMONSTRATES THAT CABLE OPERATORS WOULD OTHERWISE ACQUIRE AND ABUSE MARKET POWER OVER VIDEO PROGRAMMERS.....	4
II. MARKETPLACE CONDITIONS ON WHICH THE REQUIRED MARKET POWER ANALYSIS MUST BE BASED HAVE CHANGED DRAMATICALLY.....	16
A. Growth in Non-Cable Programming Purchasers And Distributors.....	16
B. The Widespread Deployment Of Digital Technology.....	24
C. Growth In The Supply And Diversity Of Video Programming .....	25
D. Evidence Of Increasing Programmer Leverage In Carriage Negotiations.....	26
III. THE COMMISSION SHOULD APPLY WELL-ESTABLISHED ECONOMIC PRINCIPLES IN EXAMINING WHETHER CABLE CONCENTRATION WOULD CREATE A SERIOUS NON-CONJECTURAL RISK OF CABLE ABUSE OF BUYER MARKET POWER.....	29
A. The Relevant Video Programming Market Is Much Broader Than Merely The Carriage Of Video Programming Networks By MVPDs.....	30
B. The Market Power Analysis Must Reflect The Dynamic Effects Of Retail Competition And Other Real-World Constraints On The Incentives And Behavior Of Sellers And Purchasers Of Video Programming.....	35
C. Real-World Constraints In the Highly Dynamic Video Programming Marketplace Call Into Question Whether A Subscriber Limit Can Be Justified By Any Of The Posited Theories Of Competitive Harm.....	39
1. Monopsony Power is not a Realistic Concern in this Context.. .....	42

2.	A Subscriber Limit on Cable Ownership Concentration Could Not Rationally Be Based upon Concerns that Cable Companies Might Take Advantage of Sunk Programming Investments to "Hold Up" Video Programmers.....	46
3.	Vertical Foreclosure by Cable MSOs is Not a Realistic Concern.....	49
D.	Existing Safeguards Cannot Be Ignored.....	54
IV.	THERE ARE NO VALID "SHORTCUTS" TO THE REQUIRED DYNAMIC MARKET POWER ANALYSIS.....	57
A.	The Implicit Lerner Index, The Q Ratio, And The HHI.....	57
B.	The "Open Field" Approach.....	58
1.	The Size of the Open Field.....	59
2.	The Collusion Assumption.....	66
V.	THE SIGNIFICANT PRO-COMPETITIVE BENEFITS ASSOCIATED WITH INCREASED CABLE CONCENTRATION MUST ALSO BE CONSIDERED.....	68
VI.	THE COMMISSION SHOULD ABANDON THE "SALE OF PROGRAMMING" ATTRIBUTION RULE BUT SHOULD RETAIN THE "SINGLE MAJORITY SHAREHOLDER" EXEMPTION TO ATTRIBUTION.....	70
A.	A Rule Preventing Insulated Status As A Result Of Program Sale is Impermissible.....	71
1.	The No-Sale Rule is Irrational and Inconsistent with Commission Precedent.....	71
2.	The Existing Insulated Limited Partnership Rules Cannot be Read to Support a No-Sale Rule.....	73
3.	The <i>Twentieth Century</i> Case, Even Assuming that it Was Correctly Decided, is Inapposite.....	75
B.	There Is No Theoretical Or Empirical Basis To Eliminate The Single Majority Shareholder Exemption.....	77
	CONCLUSION.....	82

**Before The  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554**

In the Matter of	)	
	)	
Implementation of Section 11 of the Cable	)	CS Docket No. 98-82
Television Consumer Protection and Competition	)	
Act of 1992	)	
	)	
Implementation of Cable Act Reform Provisions	)	CS Docket No. 96-85
of the Telecommunications Act of 1996	)	
	)	
The Commission's Cable Horizontal and Vertical	)	MM Docket No. 92-264
Ownership Limits and Attribution Rules	)	
	)	
Review of the Commission's Regulations	)	MM Docket No. 94-150
Governing Attribution Of Broadcast and	)	
Cable/MDS Interests	)	
	)	
Review of the Commission's Regulations and	)	MM Docket No. 92-51
Policies Affecting Investment In the Broadcast	)	
Industry	)	
	)	
Reexamination of the Commission's Cross-	)	MM Docket No. 87-154
Interest Policy	)	

**COMMENTS OF AT&T**

Pursuant to the Commission's Further Notice of Proposed Rulemaking ("*Notice*") in the above-captioned proceeding, FCC 01-263 (Sept. 21, 2001), AT&T hereby respectfully submits these comments.

**INTRODUCTION AND SUMMARY**

Section 613(f) of the Communications Act required the Commission to conduct a proceeding in which it would seek to "enhance effective competition" by adopting "reasonable" limits on the number of subscribers that may be "reach[ed]" by a single cable operator. In *Time Warner Entertainment Co. v. FCC*, 240 F.3d 1126 (D.C. Cir. 2001) ("*Time Warner II*"), the court of appeals reviewed for the first time and vacated the subscriber limits that the Commission

had adopted in 1993 and revised in 1999. The *Notice* asks what “limits” are now “reasonable,” in light of the court’s constitutional and statutory holdings, the Commission’s longstanding policy against unnecessary regulation, and the extraordinary changes in the structure of the video programming marketplace that have occurred since the enactment of § 613(f).

AT&T’s Comments are divided into six parts. Part I addresses the legal framework that governs this proceeding. Under *Time Warner II*, the Commission cannot adopt a specific numerical subscriber limit unless it demonstrates that there is a “real” and “non-conjectural” risk that cable operators can and will engage in harmful anticompetitive behavior by abusing “market power” over video programmers, thereby “unfairly” impeding the flow of video programming. *Time Warner II* further establishes that the Commission’s market power analysis must be based on a dynamic assessment of real world marketplace conditions and behavior rather than the static “market share” approach embodied in the “open field” analysis employed in earlier orders. *Time Warner II* thus confirms that Section 613(f) permits the Commission to adopt speech-restricting structural limits on cable ownership concentration only if, and to the extent that, such limits are shown to be necessary to prevent anticompetitive abuses of market power – a standard that is fully consistent with the Commission’s own longstanding policy of relying on market forces and imposing regulation only where there is a market failure that regulation can address effectively. Thus, although the Commission can and should resolve the buyer market power questions that motivated Section 613(f) in this industry-wide rulemaking proceeding (and not on an *ad hoc* case-by-case basis), the Commission must do so by applying the *Time Warner II* dynamic market power framework to the record evidence

Part II discusses the structural and other conditions that exist in today’s video programming marketplace. Producers of video programming now have numerous domestic and

foreign outlets for distribution of their programs in addition to U.S. providers of multi-channel video programming distribution (“MVPD”) services. Consumers likewise have numerous MVPD and non-MVPD outlets for obtaining video programming. Virtually all consumers now have multiple alternatives to cable, which include other MVPD outlets, and consumers can and do switch from cable service to direct broadcast satellite (“DBS”) and other MVPD services if cable operators do not offer the programming that consumers demand.

Part III provides the dynamic market power-based analysis that is required by *Time Warner II*. The ultimate question is whether cable operators have any residual market power over any retail cable customers. Rather, the question is whether there are concentrations of cable ownership that would give cable operators the incentive and ability to exercise market power over video programmers in a way that would unfairly impede the flow of programming that consumers demand. There are many reasons why the abstract theories of anticompetitive harm catalogued in the *Notice*, cannot, in this context, be linked to any non-conjectural risk of real-world harm. But one overriding fact is that regardless of the number of subscribers served by any cable multiple system operator (“MSO”), the existence and ubiquitous availability of DBS and other alternative outlets means that MSOs are competitively required to carry programming from a variety of services, including both affiliated and non-affiliated programmers, that is appealing to consumers. Further, as explained below, other structural characteristics of the market for video programming cause many of the theorized risks of anticompetitive behavior actually to *decline* as the number of an MSO’s subscribers increases.

Part IV explains that the formulaic approaches identified in the *Notice* cannot substitute for the required dynamic market power analysis or satisfy the *Time Warner II* mandate. In particular, Part IV demonstrates that the “open field” analysis employed in the *1999 Horizontal*

*Order* is economically and legally unsound. The open field approach relies on static market shares and flawed assumptions, and fails to take into account the elasticity of supply and demand and examination of alternatives required in order to make a meaningful assessment of market power.

Part V describes the efficiency benefits from cable expansions and territorial consolidations, which Congress expressly directed the Commission in § 613(f)(2)(D) “to take into account.” These benefits are significant, and include economies of scale in administration, operations, and research and development. Increased scale facilitates the ability of cable MSOs to deploy digital cable and advanced two-way services. Thus, even if a non-conjectural risk that cable ownership concentration would threaten video programmers in a competitively relevant way could be demonstrated, the Commission would need to weigh that potential public interest harm against the significant public interest benefits of increased concentration.

Part VI addresses the attribution rules that determine how many subscribers an MSO will be deemed to serve. *Time Warner II* properly vacated the “sale of programming exception” to the safe harbor for limited partnership interests, and reinstating any such exception would be irrational and inconsistent with Commission precedent. In contrast, reasoned decisionmaking requires reinstatement of the exception to the attribution rules for minority interests in corporations with a single majority shareholder.

## ARGUMENT

### **I. UNDER THE APPLICABLE LEGAL FRAMEWORK, SUBSCRIBER LIMITS CAN BE IMPOSED ONLY IF, AND ONLY TO THE EXTENT THAT, RECORD EVIDENCE DEMONSTRATES THAT CABLE OPERATORS WOULD OTHERWISE ACQUIRE AND ABUSE MARKET POWER OVER VIDEO PROGRAMMERS.**

Section 613(f) was enacted in response to specific conditions prevailing in 1992, and it requires only that the Commission conduct a proceeding to study market conditions and take that

action which it finds to be “reasonable” under a traditional competitive analysis. And because subscriber limits would interfere with constitutionally-protected speech, any limits must be reasonably tailored to address a demonstrated non-conjectural risk of anticompetitive behavior arising from concentration of cable ownership that, if left unconstrained, would give one or more large MSOs the ability and incentive to abuse market power over video programmers and thereby unfairly impede the flow of programming to consumers. By upholding these principles, *Time Warner II* has both confirmed that Congress did not place the Commission in a straightjacket (as some had misperceived) and allowed the Commission to apply sound economics in determining what constitute “reasonable [subscriber] limits” in today’s market structure.

**Section 613(f)’s Terms And Legislative History.** Section 613(f) of the Communications Act was enacted as part of the 1992 Cable Act. At that time, cable faced only negligible competition in the provision of MVPD services, and Congress found that the cable industry was becoming more concentrated, 1992 Cable Act § 2(a)(4), 106 Stat. at 1460. Although this did not establish that further concentration would interfere with the free flow of video programming, Congress was concerned that it might. Congress thus directed the Commission to conduct a proceeding to study the matter and impose whatever subscriber limits were “reasonable” based on a comprehensive analysis of prevailing marketplace conditions.

In particular, § 613(f) provides that “[I]n order to enhance effective competition,” the Commission shall, “within one year after [enactment of the 1992 Cable Act], conduct a proceeding to . . . prescribe rules and regulations establishing reasonable limits on the number of cable subscribers a person is authorized to reach through cable systems owned by such persons or in which such person has an attributable interest.” 47 U.S.C. § 533(f). Congress also

provided the factors for the Commission to consider. Congress directed the Commission to “ensure” that no cable operator or group of operators acting in concert could “*unfairly* impede” the flow of programming between producers and consumers or favor affiliated programming. *Id.* § 533(f)(2)(A) (emphasis added). Congress required the Commission to “take particular account” of the “nature and market power of the local [cable] franchise,” the “market structure, ownership patterns, and other relationships of the cable television industry,” and “the dynamic nature of the communications marketplace.” *Id.* § 533(f)(2)(C) & (E). Congress also directed the Commission to “account for any efficiencies and other benefits that might be gained through increased ownership or control” and prohibited it from “impos[ing] limitations which would impair the development of diverse and high quality video programming.” *Id.* §§ 533(f)(2)(D) & (G). The Commission was thus required to “balance the concerns expressed about concentration with the efficiencies gained by greater integration.” *See* S. Rep. No. 92, 102d Cong., 1<sup>st</sup> Sess. 34 (1991).

Two aspects of § 613(f) are particularly noteworthy. First, Congress drew no conclusions about whether numerical subscriber limits were in fact necessary and, if so, what limits were then reasonable. Congress was concerned that increased horizontal concentration of cable ownership *might* cause cable operators to acquire and exercise market power over video programmers in ways that could harm consumers. *See* H.R. Rep. No. 268, 102 Cong., 2d Sess. 43 (1992); 1992 Cable Act § 2(a)(4), 106 Stat. at 1460 (noting that “the *potential* effects of such concentration are barriers to entry for new programmers”) (emphasis added).

However, Congress acted against the background of the 1990 conclusions of the Antitrust Division of the Department of Justice (“DOJ”) that it was far from “clear that there is any need for general regulatory limits on cable system size to prevent the exercise of any monopsony

power.” Reply Comments of the United States Department of Justice, MM Docket No. 89-600, at 5-6 (filed Apr. 2, 1990). The DOJ warned that the undoubted “bargaining power” of cable operators “should not be confused with monopsony power” unless “structural analysis” or “empirical observation” indicates “any imminent danger” that cable operators of sufficient size could and would use market power to impede the flow of video programming to consumers. *Id.* Thus, rather than prescribe subscriber limits, Congress mandated only that the Commission study the matter and adopt those limits that were found “reasonable” under specific statutory criteria that focused on the very factors that the DOJ had identified.

Second, § 613(f) directed a proceeding that was triggered by conditions prevailing in 1992. After the Commission conducted the proceeding and established “reasonable” limits based on the then-prevailing conditions, § 613(f) places no restriction on the authority of the Commission to modify or eliminate those limits as conditions change. The Commission was, and is, free, on the basis of any material change in conditions, to vacate any limits set in the initial proceeding altogether, for all that § 613(f) mandated was that determinations be made based on the conditions prevailing at the time of the initial proceeding.

**The Prior Commission Orders and *Time Warner II*.** The Commission conducted the required proceeding in 1993,<sup>1</sup> and revisited the question in 1999.<sup>2</sup> Both times, it felt compelled

---

<sup>1</sup> Second Report and Order, *Implementation of Sections 11 and 13 of the Cable Television Consumer Protection and Competition Act of 1992, Horizontal and Vertical Ownership Limits*, 8 FCC Rcd. 8565 (1993) (“*Second Report*”).

<sup>2</sup> Third Report and Order, *Implementation of Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992 Horizontal Ownership Limits*, 14 FCC Rcd. 19098 (1999) (“*1999 Horizontal Order*”). The principal revision to the subscriber limit made by the Commission in the *1999 Horizontal Order* was to change the how the denominator of the limit was calculated – *i.e.*, the Commission decided to use total MVPD subscribers rather than cable homes-passed. In a companion order, the Commission also separately revised the attribution rules adopted in the *Second Report*. See Report and Order, *Implementation of the Cable* (continued . . .)

to take a “conservative” approach, in which it resolved analytic or factual doubts in favor of more stringent ownership limits, and both times the Commission concluded that a 30% ownership concentration limit was appropriate.

The *1999 Horizontal Order* employed a static “open field” analysis based on the market shares of cable operators in the MVPD “market.” The Commission’s stated objective was to protect the ability of a programming “network” to obtain cable carriage and to remain economically viable even if denied carriage on the systems of the largest cable operators. Towards that end, the Commission set a limit that was designed to assure that there would be an “open field” of systems that are not affiliated with the largest cable operator and that serve 40% of MVPD subscribers. Because it also assumed (without evidentiary or even anecdotal support) that the two largest cable operators would collude, the Commission found that a subscriber limit of 30% was required to assure that programmers would have access to systems serving 40% of MVPD subscribers. The Commission stated that the 30% limit would also foster “diversity” because it would guarantee that there were a minimum of four cable MSOs.

Because the Commission stayed the subscriber limit in the wake of the district court’s erroneous ruling that § 613(f) was unconstitutional on its face,<sup>3</sup> the 30% limit was not subjected to judicial review until the recent decision in *Time Warner II*. The court of appeals vacated the 30% limit on the ground that it violated both § 613(f) and the First Amendment, which require

---

(... continued)

*Television Consumer Protection and Competition Act of 1992 Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996 Review of the Cable Attribution Rules*, 14 FCC Rcd. 19014 (1999) (“*1999 Attribution Order*”).

<sup>3</sup> The court of appeals found that § 613(f) was “facially constitutional.” *Time Warner Entertainment Co., L.P. v. United States*, 211 F.3d 1313 (D.C. Cir. 2000) (“*Time Warner P*”).

the Commission to prove, rather than simply assume, the existence of any harms sought to be remedied through an ownership limit.

*Time Warner II* ruled that, even under a static “open field” analysis, the 30% limit was unsustainable, because there was no non-conjectural support for the collusion assumption which had reduced the limit from 60% to 30%. Thus, even if a static open field analysis were permissible, the court held that the “present record supports no more” than a subscriber limit of 60%. *Id.* at 1136.

However, the court went on to emphasize that § 613(f) required proof of a non-conjectural risk of anticompetitive behavior before *any* particular limit could be imposed and that, in turn, required proof that cable operators of a particular size would have market power. The court stated that a showing of market power ordinarily required not a mere showing of high market share, but evidence that there were no alternatives that would constrain the behavior of cable operators. The court thus stated that it “seems clear” that in “revisiting the horizontal rules, the Commission will have to take account of the impact of DBS [and other alternatives] on [the claimed] market power” of cable operators and cannot rely on the mere share of current subscribers. *Id.* at 1134.

**The Legal Framework Mandated By *Time Warner II*.** The court’s decision in *Time Warner II* establishes that there are two interrelated and very substantial showings that must be made before any numerical subscriber limit can be justified.

*Limits Must Be Narrowly Tailored to Address Actual Risks.* The first showing derives from the First Amendment itself. *Time Warner II* recognized that any subscriber limit “interferes with petitioners’ speech rights by restricting the number of viewers to whom they can speak.” 240 F.3d at 1129. Accordingly, any such limit must pass constitutional muster under the

“intermediate” standard of scrutiny. Under that standard, a subscriber limit can be upheld only if it “advances important governmental interests unrelated to the suppression of free speech and does not burden substantially more speech than necessary to further those interests.” *Id.* at 1130 (quoting *Turner Broadcasting System, Inc. v. FCC*, 520 U.S. 180, 189 (1997) (“*Turner II*”)).

It is not enough to point to some abstract problem that a particular subscriber limit might cure. Rather, the Commission “bears the burden of showing that its restriction of speech is justified.” *United States v. Doe*, 968 F.2d 86, 90 (D.C. Cir. 1992); see also *Quincy Cable TV, Inc. v. FCC*, 768 F.2d 1434, 1457 (D.C. Cir. 1985) (government bears “heavy burden”). To do that, it “must demonstrate that the recited harms are real, not merely conjectural, and that the regulation will in fact alleviate these harms in a direct and material way.” *Turner Broadcast Sys., Inc. v. FCC*, 512 U.S. 622, 624 (1994) (“*Turner I*”) (plurality); see *Edenfield v. Fane*, 507 U.S. 761, 771 (1993).

The Commission thus cannot impose a numerical subscriber limit unless the record “convincingly shows a problem to exist.” *Home Box Office, Inc. v. FCC*, 567 F.2d 9, 50 (D.C. Cir. 1977) (per curiam); see also *Century Communications Corp. v. FCC*, 835 F.2d 292, 304 (D.C. Cir. 1987); *Quincy*, 768 F.2d at 1454 & n.48. In this connection, the agency’s findings of fact are not entitled to deference. See *Turner I*, 512 U.S. at 665-66 (plurality); *id.* at 671 n.2 (Stevens, J., concurring in part and concurring in the judgment); *Doe*, 968 F.2d at 90; *Century Communications*, 835 F.2d at 299. And regulation based upon predictions of future conduct under different conditions are viewed with particular suspicion: to the extent they are “susceptible of empirical proof,” that proof must be provided. *Quincy*, 768 F.2d at 1457-58. Moreover, where “there is no evidence of any urgent need for preventive action,” the agency is not entitled to the “benefit of the doubt.” *HBO*, 567 F.2d at 37 n.60.

This First Amendment framework also requires the Commission to consider the extent to which other remedies protect the government's interest in enhancing effective competition. In the *1999 Horizontal Order* (§ 18), the Commission stated that it need not consider the extent to which existing restrictions on anticompetitive conduct, including the antitrust laws and a variety of limits imposed by the Communications Act and Commission regulations, protect the interest in effective competition, reasoning that § 613(f) requires an analysis of seven public interest factors, "none of which involves an antitrust analysis." See *1999 Horizontal Order* § 18. *Time Warner II*, however, requires the Commission both to prove the existence of any problem to be remedied, 240 F.3d at 1133, and to "justify the limits that it has chosen as not burdening substantially more speech than necessary," *id.* at 1130. Compliance with these directives is not possible without first considering the extent to which restrictions already in place ensure effective competition.<sup>4</sup>

*Proof of Market Power Under Dynamic Analysis.* But *Time Warner II* did more than set forth the constitutional standards governing the validity of any subscriber limit. The court further identified the governmental interests that any such limit must serve under the terms of § 613(f). The court recognized that the "'interrelated interests' of promoting diversity and fair competition run throughout the 1992 Cable Act's various provisions." *Time Warner II*, 240 F.3d at 1136 (quoting *Turner II*, 520 U.S. at 189). The court found, however, that "Congress's primary concern in authorizing ownership limits is 'fair' competition" and that diversity is

---

<sup>4</sup> The *Notice* suggests (§ 2 n.7) that the court of appeals rejected this claim in the earlier decision where it rejected a "facial" challenge to § 613(f). That is incorrect. In rejecting that facial challenge, the court held only that § 613(f) was not *certain* to infringe protected speech in an unconstitutional manner "no matter how sensitively and sensibly" it was implemented. *Time Warner I*, 211 F.3d at 1315. The court holding thus established only that there were conceivable sets of facts in which prophylactic subscriber limits would be required to supplement existing regulations, not that this was necessarily the case.

merely a byproduct of requirements that assure that there are at least two outlets for video programming. *Id.* at 1136 (emphasis in original). The court explained that “the relevant section,” subsection (f)(2)(A), “addresses only ‘unfair[]’ impediments to the flow of programming,” *id.* at 1135, and that “[t]he statute specifies . . . that *these* regulations are to be promulgated ‘[i]n order to enhance effective competition,’” *id.* at 1136 (quoting 47 U.S.C. § 533(f)(1)) (emphasis in original). Thus, to be valid, any subscriber limit must be shown necessary to eliminate a “real risk” of anticompetitive behavior, and the court held that such a risk can exist only if serving a particular number or percentage of cable subscribers would create the incentive and ability for MSO market power abuse of video programmers. *Id.* at 1134.

In this regard, the court made it explicit that a subscriber limit cannot be predicated on a static, market *share* analysis. Instead, any limit must be based on a dynamic examination of market *power* that takes into account all of the factors that determine whether MSOs could and would actually exercise power over programmers to the detriment of consumers. As the court explained, “the assessment of a real risk of anticompetitive behavior – collusive or not – is itself dependent on an understanding of market power.” *Id.* at 1134. And

a company’s ability to exercise market power depends not only on its share of the market, but also on the elasticities of supply and demand, which in turn are determined by the *availability* of competition. If an MVPD refuses to offer new programming, customers with access to an alternative MVPD may switch. The FCC shows no reason why this logic does not apply to the cable industry. Indeed, its most recent competition report suggests that it does.

*Id.* (emphasis in original). Although DBS has fewer subscribers than cable today, “the annual increase in its total subscribership is almost three times that of cable.” *Id.* at 1133. “Already, when the *Third Report* was written, DBS could be considered to ‘pass every home in the country.’ The technological and regulatory changes since then appear only to strengthen petitioners’ contention.” *Id.* at 1134 (citations omitted). Accordingly, “in revisiting the

horizontal rules the Commission *will have to take account of the impact of DBS on th[e] market power [of cable MVPDs].*” *Id.* (emphasis added).

The import of this discussion is plain. First, in determining whether cable MSOs could or would abuse market power over their programming suppliers, the Commission must consider all of the alternative outlets available to suppliers, because a supplier’s susceptibility to victimization by a large purchaser is necessarily a function of all alternative channels for sale or distribution of the supplier’s product. The court, of course, identified one prominent alternative, DBS. But, as detailed below, programmers have many other MVPD and non-MVPD distribution alternatives that cannot be ignored in the market power analysis.

Relatedly, the Commission must examine the manner in which cable MSOs (and their customers) and alternative MVPDs (and their customers) make and respond to programming decisions. As the court explained, where DBS is available, there is no reason to presume that it is in a cable MSO’s economic interest to make program-purchasing decisions that promote its own programming interests at the expense of consumer demand. In such circumstances, viewers will switch away from the cable MSO’s service in favor of a DBS provider that offers programming viewers prefer. Similarly, alternative outlets can respond to and satisfy unmet consumer demand for programming that MSOs fail to satisfy, thereby targeting competitive rivals that fail to optimize their consumer offerings.

Finally, the court made clear that the Commission must assess the validity of programmer claims of “victimization” in light of the foregoing dynamic market forces. The court emphasized that subsection (f)(2)(A) of section 613 authorizes the Commission to prevent “unfair[] impediments to the flow of programming.” *Id.* at 1135. Even the broadest interpretation of the term “unfair,” the court explained, “is plausible *only* for actions that impinge at least to some

degree on the interest in competition that lay at the heart of Congress's concern." *Id.* (emphasis in original). If there are at least two outlets and no collusion, the court concluded, a programmer's failure to reach homes would be the result of "the legitimate, independent editorial choices of multiple" entities, not editorial choices that can plausibly be deemed "unfair." *Id.*<sup>5</sup> Thus, in order to justify any subscriber limit, a programmer's inability to reach a sufficiently large audience must be the result of a breakdown in competitive market forces, not the outcome of legitimate competition seeking to satisfy consumer demand, and any attempt to promote "more is better" diversity beyond the two-outlet minimum would therefore exceed the Commission's authority under § 613(f).<sup>6</sup>

**The Notice.** The *Notice* recognizes much of the import of the court's decision. Noting that the court faulted it "for mistakenly equating market share with market power," the Commission acknowledges that it must "consider the pervasive presence of DBS and its impact on MSOs' market power in the upstream and downstream video programming markets." *Notice* ¶ 49. Any subscriber limit "must be set in the context of MVPDs' market power," and "the availability of an alternative MVPD outlet affords programmers access and consumers choice, and erodes cable's or an MSO's market power irrespective of current market share." *Id.* ¶ 50. In

---

<sup>5</sup> See also *id.* at 1135 ("Congress has not given the Commission authority to impose, solely on the basis of the 'diversity' precept, a limit that does more than guarantee a programmer two possible outlets."); *id.* at 1136 ("[T]he fact that Congress's interest in anti-competitive behavior may have been animated by an interest in preserving diversity doesn't give the FCC cart blanche to hobble cable operators in the name of the latter value alone.").

<sup>6</sup> This understanding of the Commission's authority to consider diversity is fully consistent with § 613(f), which does not authorize the Commission affirmatively to promote diversity, but rather directs it to ensure that any ownership limitation will "not . . . impair the development of diverse and high quality video programming." 47 U.S.C. § 533(f)(2)(G); see also 1992 Cable Act § 2(b)(1) & (2), 106 Stat. at 1460 (although the policy of the 1992 Cable Act is to "promote the availability . . . of a diversity of views and information," the Commission should "rely on the marketplace, to the maximum extent feasible, to achieve that availability").

fact, the Commission has all but formally acknowledged that a properly constructed dynamic market power standard is the only regulatory approach that “can satisfactorily address the issues raised in the *Time Warner* decision.” *Id.* ¶ 51. A dynamic analysis that uses measures of market power rather than market share would (1) “be more sophisticated than market share measures in that it would target directly the source of the potential harm: the cable industry’s control over programmers access to the home”; (2) “conform to the intent of Congress as expressed in the statute to prefer competition over regulation”; and (3) conform “with the opinion of the court in *Time Warner*.” *Id.* ¶ 60.

***Time Warner II* Frees The Commission To Apply Its Settled Policies.** *Time Warner II* has thus freed the Commission of any misconception that § 613(f) necessarily requires the imposition of stringent subscriber limits, regardless of the marketplace conditions that now exist. By holding that numerical subscriber limits can be imposed only if they are necessary to prevent cable operators from acquiring and abusing market power, *Time Warner II* has permitted (and required) the Commission to begin the subscriber limit inquiry anew against the backdrop of its historical presumption against regulation.

The Commission has long held that it “should consider the imposition of regulation” only “when there is an identifiable market failure,” and only when the regulation “would serve the public interest because it is targeted to correct that failure.” *See, e.g.,* Notice of Proposed Rulemaking, *1998 Biennial Regulatory Review – Spectrum Aggregation Limits for Wireless Telecommunications Carriers*, 13 FCC Rcd. 25132, ¶ 5 (1998). These policies are entirely consistent with *Time Warner II*. Absent proof that cable operators would acquire market power that they would have incentives to abuse if they reach specific numbers or percentages of subscribers, there is no market failure and no basis for regulation. Thus, only a dynamic analysis

of market power, based on a comprehensive understanding of market structure and the ability of market participants to respond to competitive signals and consumer demand, can adequately account for the factors that both the court and the Commission have identified as paramount to the Commission's inquiry on remand.

By the same token, the court's analysis effectively sounds the death knell for the Commission's "open field" approach. The "open field" approach is predicated on precisely the type of static market share analysis that *Time Warner II* emphatically rejected and fails entirely to account for "the elasticities of supply and demand" or "the availability of competition" that the court deemed critical. 240 F.3d at 1134 (emphasis deleted). Moreover, as detailed below, the critical assumptions underlying any open field-based regulation could neither be supported nor reconciled with the court's analysis.

## **II. MARKETPLACE CONDITIONS ON WHICH THE REQUIRED MARKET POWER ANALYSIS MUST BE BASED HAVE CHANGED DRAMATICALLY.**

The video programming marketplace has, by any measure, undergone dramatic and highly relevant changes in the decade since passage of the 1992 Cable Act.

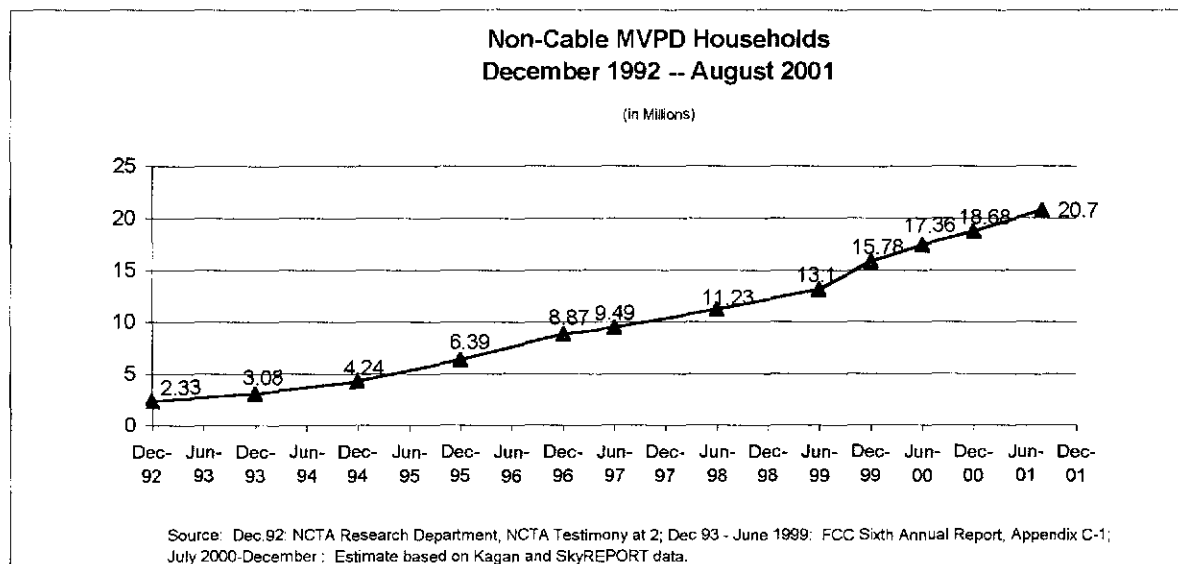
### **A. Growth In Non-Cable Programming Purchasers And Distributors.**

In 1992, cable and broadcast TV were the primary outlets for distributing video programming. Today, video programming is distributed worldwide by cable, broadcasting, DBS, C-band satellite, MMDS, SMATV, cable overbuilders, and, soon, terrestrially delivered MMVDS. Non-cable MVPD subscribership has grown nearly ten-fold since 1992,<sup>7</sup> and non-

---

<sup>7</sup> See *Status of Competition in the Multichannel Video Programming Distribution Marketplace: Hearings Before the House Commerce Comm., Subcomm. on Telecommunications and the Internet*, 107<sup>th</sup> Cong. 2 (Dec. 4, 2001) ("NCTA Testimony") (<http://www.ncta.com/press/press.cfm?PRid=205&showArticles=ok>).

cable MVPDs now serve approximately 20.7 million U.S. MVPD households, accounting for 23% of multichannel video customers nationwide.<sup>8</sup>



Analysts agree that this trend will continue. Kagan Media, for example, estimates that non-cable distributors will soon account for 25% of MVPD subscribers.<sup>9</sup> The Strategis Group projects that by 2006 non-cable MVPDs will have revenues of approximately \$20.5 billion, almost half of the revenue cable operators are expected to realize.<sup>10</sup>

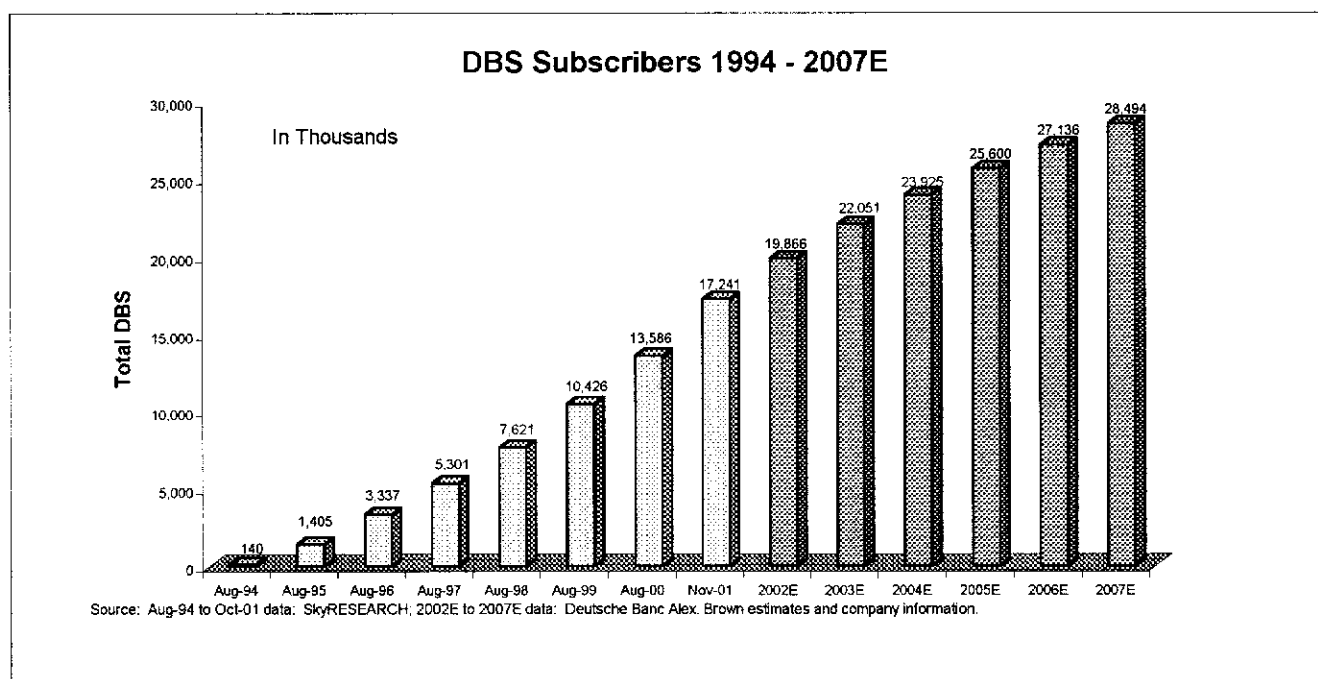
As the *Notice* recognizes (§ 22), “[p]erhaps the most important difference between the industry in 1992 and today is that in 1992 there was no clear nationwide substitute for cable.

<sup>8</sup> See Paul Kagan Media Assocs., *Media Index Database*, Kagan Media Money, June 26, 2001, at 11 (“Kagan Media Index Database”); Press Release, EchoStar Communications Corp., *EchoStar Reports Over \$1 Billion of Revenue, Record EBITDA and Net Income in Third Quarter* (Oct. 23, 2001) (“EchoStar Press Release”) ([http://www.corporate-ir.net/ireye/ir\\_site.zhtml?ticker=dish&script=410&layout=-6&item\\_id=218915](http://www.corporate-ir.net/ireye/ir_site.zhtml?ticker=dish&script=410&layout=-6&item_id=218915)); Press Release, Hughes Elecs. Corp., *Hughes Revenue Grows by 25%; Strong DIRECTV U.S. Subscriber Growth Beats Expectations* (Oct. 17, 2001) (“DirecTV Press Release”) ([http://www.hughes.com/ir/pr/01\\_10\\_17\\_3rd\\_quarter.xml](http://www.hughes.com/ir/pr/01_10_17_3rd_quarter.xml)).

<sup>9</sup> See Kagan Media Index Database at 11.

<sup>10</sup> See Charles Dorrier *et al.*, The Strategis Group, *U.S. Digital Cable Market: Beyond IPGs and the 200 Channel Future*, at 48, 50 (May 2001).

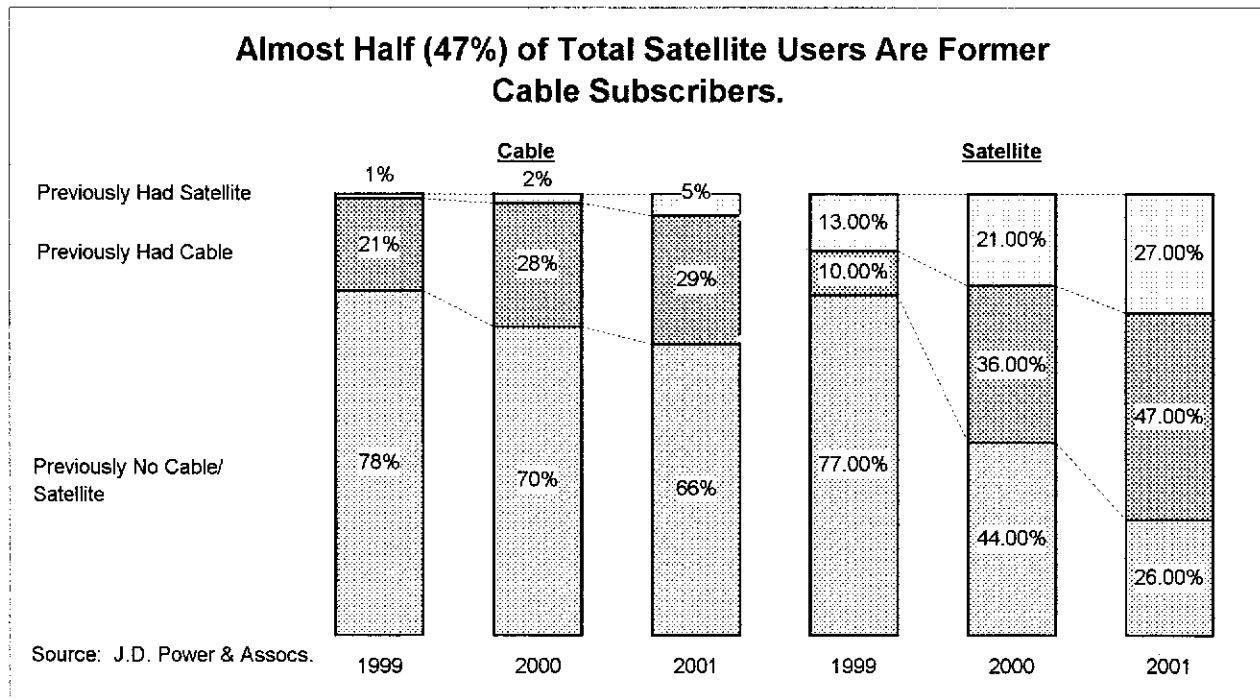
Today, on the other hand, DBS has a national footprint and . . . it appears that DBS currently offers an effective alternative path through which program networks can reach subscribers.” In less than ten years, DBS has grown from serving *no* multichannel video subscribers to serving over 17 million subscribers, almost 19% of all MVPD subscribers.



Last year alone, DBS grew *twenty times faster* than cable, with both DirecTV and EchoStar experiencing tremendous subscriber growth. See Seventh Annual Report, *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 16 FCC Rcd. 6005, ¶ 14 (2001) (“2000 Video Competition Report”) (comparing 1.5% growth rate for cable with 29% growth rate for DBS). DirecTV expects to add 1-1.2 million new subscribers in 2002,<sup>11</sup> while EchoStar anticipates a 2001 net increase in subscribers of 1.5 to 1.75

<sup>11</sup> Ann Donahue, *DirecTV Parent Sees 10% Growth Next Year*, Video Business Online (Nov. 14, 2000) ([http://www.videobusiness.com/news/111401\\_directv\\_forecast.asp](http://www.videobusiness.com/news/111401_directv_forecast.asp)).

million, with similar growth in 2002.<sup>12</sup> DirecTV is already the third largest MVPD operator and EchoStar is the sixth largest.<sup>13</sup> Perhaps most relevant in this proceeding, four out of five new multichannel video customers now are choosing DBS over cable,<sup>14</sup> and almost one-half of existing DBS subscribers are former cable customers.<sup>15</sup>



This rapid DBS growth has been fueled by aggressive marketing campaigns aimed specifically at converting cable subscribers, using a variety of promotional tactics, including ad

<sup>12</sup> EchoStar Communications Corp., *Q3 Quarterly Report* at 17 (Oct. 23, 2001) ([http://media.corporate-ir.net/media\\_files/NSD/dish/q32001.pdf](http://media.corporate-ir.net/media_files/NSD/dish/q32001.pdf)).

<sup>13</sup> Compare SkyREPORT, *National DTH Counts November 2000 – November 2001* (“November 2001 SkyReport DTH Count”) (reporting that DirecTV has 10.58 million subscriber and EchoStar has 6.67 million subscribers) ([http://www.skyreport.com/dth\\_us.htm](http://www.skyreport.com/dth_us.htm)) with National Telecom. Cable Ass’n, *Top 25 MSOs* ([http://www.ncta.com/industry\\_overview/top50mso.cfm](http://www.ncta.com/industry_overview/top50mso.cfm)).

<sup>14</sup> See NCTA 2001 Video Competition Comments at 8.

<sup>15</sup> See J.D. Power & Assocs., *2001 Syndicated Cable/Satellite TV Customer Satisfaction Study*, at 79 (Sept. 2001).

campaigns emphasizing various DBS program offerings, e.g., DirecTV's "NFL Sunday Ticket" and "Blockbuster Ticket," that are not available on cable.<sup>16</sup> A recent survey of cable subscribers showed that over 85% were aware of DBS as an alternative to cable services.<sup>17</sup>

To the extent that DBS was once viewed as an imperfect substitute for cable because its service did not include local broadcast signals, recent legislation has removed that impediment. DBS already retransmits local signals that cover approximately *fifty-three million* multichannel subscriber households, or more than 60% of the MVPD universe.<sup>18</sup> EchoStar and DirecTV plan to further expand their local-into-local offerings by launching four new spot-beam satellites in the next year.<sup>19</sup>

---

<sup>16</sup> See Armand Musey, Solomon Smith Barney, *Satellite Communications & Towers*, at 4, 7 (Oct. 9, 2001) (noting the "strong demand for [DirecTV's] NFL Sunday Ticket promotional plan as well as a Two-for-One set-top promotional offering"). See also DirecTV, Inc., *Pay Per View Movies* ("BLOCKBUSTER® TICKET only on DIRECTV brings you the best pay per view movies at an unbeatable price") (<http://www.directv.com/programming/programmingpages/0,1093,136,00.html>); Press Release, DirecTV, *DIRECTV Secures Exclusive National Rights to CBS Out-of-Market Broadcasts of Men's NCAA Basketball Championship for Fourth Straight Year* (Dec. 10, 2001) (<http://www.directv.com/press/pressdel/0,1112,445,00.html>). The Commission previously observed that exclusive arrangements of this sort serve to "foster DBS as a significant competitor to cable." *Implementation of the Cable Television Consumer Protection and Competition Act of 1992; Development of Competition and Diversity in Video Programming Distribution and Carriage*, 10 FCC Rcd. 3105, ¶ 39 (1994).

<sup>17</sup> See Horowitz Associates, Inc. *et al.*, *Digital TV VII: A Survey of Consumers in Digital Cable Markets*, at 35 (Apr. 2001).

<sup>18</sup> See Marc E. Nabi *et al.*, Merrill Lynch, *Eye in the Sky 3Q01 Preview*, at 20-21 (Oct. 8, 2001) ("Merrill Lynch Report"); Adam Simon & Barry Kaplan, Goldman Sachs, *Satellite Communications: DBS Operators*, at 27 (Dec. 18, 2000). DBS subscribers in rural areas that do not receive over-the-air broadcast network signals are able to receive network affiliates' distant signals through their DBS provider.

<sup>19</sup> See Merrill Lynch Report at 17. DirecTV recently announced the launch of DIRECTV 4S, "a powerful new spot beam satellite that will enable DIRECTV to provide hundreds of additional local channels to television households across the country." Press Release, DirecTV, Inc., *DIRECTV Successfully Launches Spot Beam Satellite* (Nov. 26, 2001) (<http://www.directv.com/press/pressdel/0,1112,443,00.html>).

Moreover, DBS enjoys a number of competitive advantages, including digital technology that gives it greater channel capacity than many cable systems.<sup>20</sup> In addition, DBS operators are not subject to local franchise fees and taxes that add significantly to cable customers' monthly bills, and "are not saddled with the costs of public access studios, institutional networks, and free municipal cable hook-ups which are required by most cable franchise agreements."<sup>21</sup>

Video programmers also distribute their programming through other MVPDs, including C-Band,<sup>22</sup> MMDS,<sup>23</sup> and SMATV operators that collectively serve 3.1 million subscribers.<sup>24</sup> Broadband overbuilders such as RCN, Knology and WideOpenWest are likewise strong

---

<sup>20</sup> See *Satellite Broad. & Communications Ass'n v. FCC*, No. 01-1151, 2001 WL 1557809, at \*2 (4<sup>th</sup> Cir. Dec. 7, 2001) ("Using their current compression ratios, EchoStar and DirecTV each have the ability to carry between 450 and 500 channels via full CONUS satellites").

<sup>21</sup> NCTA Testimony at 3.

<sup>22</sup> C-band continues to add new subscribers and will remain a viable service, as replacement satellites have been launched and new digital equipment continues to be developed and made available to consumers. See *2000 Video Competition Report* ¶¶ 84-85. C-Band service offers more than a hundred broadcast channels, and a package of two movie channels and 50 basic services can be purchased for as low as \$30 to \$35 per month. See Vogel Communications Inc., *C-band FAQs* (<http://www.orbitmagazine.com/orbfaqs.htm>). Motorola's 4DTV C-band offering includes nearly 300 channels for \$30 per month, as well as 59 subscription channels and 22 movie channels. See Motorola, Inc., *What Is 4DTV?* ([http://www.4dtv.com/4DTV/what\\_4dtv.html](http://www.4dtv.com/4DTV/what_4dtv.html)).

<sup>23</sup> See First Report and Order and Memorandum Opinion and Order, Amendment of Part 2 of the Commission's Rules to Allocate Spectrum Below 3 GHz for Mobile and Fixed Services to Support the Introduction of New Advanced Wireless Services, Including Third Generation Wireless Systems, ET Dkt. No. 00-258, ¶ 10 (Sept. 24, 2001) (noting considerable MMDS investment in "systems [that] offer a significant opportunity for further competition with cable and digital subscriber line services in the provision of broadband services in urban and rural areas").

<sup>24</sup> According to the November 2001 2001 SkyReport DTH Count, there are 870,971 C-band subscribers. Paul Kagan Associates estimates that, as of June 2001, there were 700,000 MMDS subscribers and 1.5 million SMATV subscribers. See Kagan Media Index Database at 11. Although SMATV subscriber counts have remained constant in recent periods, they are expected to grow. See *id.* at 11.

competitors and important video programming distributors,<sup>25</sup> and incumbent local exchange carriers and leading electric and gas utilities, are poised to market competitive video programming delivery alternatives.<sup>26</sup>

There are also now many important non-MVPD programming distributors. The Commission has recognized that “broadcast networks and stations are competitors to MVPDs in the advertising and program distribution markets.”<sup>27</sup> Moreover, as a result of must-carry and retransmission consent arrangements, broadcast networks can effectively ensure ubiquitous, nationwide cable exposure for programs they purchase. For example, in order to supplement their traditional MVPD subscriber viewership, some programmers, such as Bloomberg TV, provide their video feed part of the day to widely distributed cable networks or to top broadcast stations.<sup>28</sup> With the transition to digital broadcasting, broadcasters are able to multicast video programs and will become even larger consumers of video programming.

---

<sup>25</sup> In addition to providing multichannel video programming, many of these companies offer bundled communications services and have announced record growth. See, e.g., Press Release, Knology, *Knology Reports Continued Record Growth in 2<sup>nd</sup> Quarter 2001* (Aug. 1, 2001) (“total on-net connections increased by 46,911 or 37% from the second quarter 2000 resulting from substantial growth in each of the video, telephone and high speed internet product lines”) (<http://www.knology.com/about/news.releases>); RCN Comments, CS Docket No. 01-290, at 10 n.20 (filed Dec. 3, 2001) (“As of the third quarter of 2001, RCN provides 575,926 video network connections, and a total of 780,564 network connections, including voice service”).

<sup>26</sup> See 2000 Video Competition Report ¶¶ 119-120 (describing several methods that common carriers can use to provide video programming, and noting that a number of incumbent LECs are actively involved in marketing DBS service to their customers).

<sup>27</sup> *Id.* ¶ 14. NAB recently acknowledged that “[b]roadcast television stations compete with cable systems in the provision of video programming to the public and in the sale of advertising.” Brief of Amici Curiae National Association of Broadcasters, *Consumer Fed’n of Am. v. FCC*, No. 01-223, at 1 (U.S. 2001) (on petition for writ of certiorari).

<sup>28</sup> See Will Lee, *Bloomberg Jumps Ahead in Net Race*, Cableworld, July 23, 2001, at 1, 12, 16 (Bloomberg TV “is already shown for three hours every weekday morning and in several  
(continued . . .)

Foreign video programming distributors also purchase vast amounts of video programming, and foreign sales are now a substantial portion of many programming networks' business. For example, MTV reaches 370 million households in 140 countries; Nickelodeon is seen in over 300 million households worldwide; VH1 reaches 100 million households worldwide; and BET International reaches 30 countries in Europe and 36 countries in Africa.<sup>29</sup> Indeed, with 72.96 million subscribers, U.S. cable operators represent less than a quarter of the 317 million worldwide cable and DBS subscribers.<sup>30</sup>

Finally, although video sales and rental outlets are not in-home distributors of video programming, the Commission has acknowledged that "video sales and rentals [are] part of the video marketplace" and that the "home video industry considers cable television, [DBS], and broadcast television as its competition." *2000 Video Competition Report* ¶ 114. Indeed, the video retail industry is the largest source of revenue for movie studios. *See id.* ¶ 116. In any video store today, one can find video tapes and DVDs from Disney, Nickelodeon, Turner,

---

(... continued)

weekend slots on USA Network" and "is also syndicated to a large number of local over-the-air stations," thereby bringing Bloomberg TV "into a total 81 million homes each week.").

<sup>29</sup> *See* Viacom Inc., *The Facts* (<http://www.viacom.com/thefacts.tin>). Disney, Liberty Media, Fox, AOL Time Warner, MGM, Universal, and Columbia, among others, also sell their programming worldwide. *See, e.g.,* The Walt Disney Co., *2000 Annual Report* 3-8 (2000); Liberty Media Corp., *Investor Relations – Liberty Affiliate List* (last visited Oct. 29, 2001) ([http://www.health-tv.com/investor\\_relations/03-index.html](http://www.health-tv.com/investor_relations/03-index.html)); Amy Joyce, *AOL Time Warner Gets Entry Into Chinese TV*, *Washtech.com*, Oct. 23, 2001 ("AOL's 24-hour Mandarin channel, CETV, will be carried on the cable systems in the southern province of Guangdong" in addition to its current carriage in Taiwan, Singapore, Thailand, and other areas of Asia) (<http://www.washtech.com/news/media/13303-1.html>).

<sup>30</sup> *See* NCTA Industry Overview 2001, at 16 (Dec. 2001) ("2001 Cable Industry Overview") ([http://www.ncta.com/pdf\\_files/2001indovrvw.pdf](http://www.ncta.com/pdf_files/2001indovrvw.pdf)); Michelle Abraham & Mike Paxton, Cahners In-Stat Group, *Worldwide Digital Satellite and Cable TV Services* at 59, 67 (Dec. 2000).

Discovery, HBO, and many other programmers. The sale and rental of these tapes and discs obviously provides an important outlet and revenue source for video programmers.

#### **B. The Widespread Deployment Of Digital Technology.**

In 1992, the channel capacity of cable and non-cable distribution outlets was limited by analog technology. The deployment of digital technology has vastly expanded the capacity of satellite and terrestrial video distribution systems. EchoStar and DirecTV, for example, currently list 435 and 389 channels in their respective lineups.<sup>31</sup>

Cable operators have likewise significantly upgraded capacity – at a cost of over 52 billion dollars – thereby increasing greatly the number of programming networks they need to fill their channel line-ups.<sup>32</sup> By way of comparison, the Commission reported that, in 1995, the average channel capacity of cable systems was 47 channels. *See* Fourth Annual Report, *Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming*, 13 FCC Rcd. 1034, ¶ 16 (1998). As the Commission explained in 1993 even before this massive channel capacity expansion occurred: “we believe that expanded channel capacity . . . encourag[es] cable operators to carry unaffiliated or competing video programming services. . . . [T]he record indicates that vastly larger cable systems will likely be inclined to deliver targeted

---

<sup>31</sup> *See* EchoStar, *Channel Lineup for Dish Network* (<http://www.dishnetwork.com/content/programming/index.shtml>); DirecTV, *Here's the DirecTV Channel Lineup* (<http://www.directv.com/programming/programmingpages/0,1093,176,00.html>).

<sup>32</sup> *See* Stratecast Partners, *U.S. Cable MSOs: Strategic Market Assessment & Forecast 7* (Sept. 2001) (cable operators’ “plant upgrades were/are mandatory, not optional, as part of their efforts to grow their businesses and compete effectively against current and future combatants including DBS and telecommunications service providers”); PDS Consulting, *Cable TV System Capacity* 13 (Oct. 16, 2001) ([http://gullfoss2.fcc.gov/prod/ecfs/retrieve.cgi?native\\_or\\_pdf=pdf&id\\_document=6512768757](http://gullfoss2.fcc.gov/prod/ecfs/retrieve.cgi?native_or_pdf=pdf&id_document=6512768757)). *See also* 2000 *Video Competition Report* ¶¶ 9, 20-21; Sixth Annual Report, *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 15 FCC Rcd. 978, ¶¶ 15, 21-22, 25 (2000) (“1999 *Video Competition Report*”).

‘niche’ video programming services aimed at correspondingly smaller audience sizes”). *Second Report* ¶ 83.

### C. Growth In The Supply And Diversity Of Video Programming.

By any measure, the growth in the supply and diversity of video programming has been truly explosive. National satellite-delivered programming networks grew from 87 in 1992 to 281 in 2001, an increase of 223%. *See 2000 Video Competition Report* ¶ 173; 2001 Cable Industry Overview at 8. Regional programming networks grew from 29 in 1993 to 55 in 2001, an increase of 90%.<sup>33</sup>

Moreover, the proportion of cable-affiliated national programming networks has consistently declined. *See 2000 Video Competition Report* ¶ 173 (noting that “[t]he total number of programming networks has grown [while] the proportion of vertically integrated channels . . . continues to decline”). In 1994, 53% of national satellite-delivered programming networks were affiliated with a cable operator. *See 1994 Video Competition Report* ¶ 161 n.434. By 2000, only 35% were affiliated with cable. *2000 Video Competition Report* ¶ 173. And developments within the past year alone, including AT&T’s spin-off of Liberty Media have resulted in further reductions – only 73 (or 26%) of the 281 national programming networks now are affiliated with cable. *See NCTA Testimony* at 8. Conversely, the number of national satellite-delivered programming services that have no cable ownership has increased substantially from only 45 in 1992 to more than 200 today, and no single MSO has ownership interests in more than 9% of such services. *See id.*

---

<sup>33</sup> *See NCTA, Regional Cable Networks* ([http://www.ncta.com/industry\\_overview/programList.cfm](http://www.ncta.com/industry_overview/programList.cfm)).

Empirical evidence also shows that, even during the period of higher vertical concentration, cable operators did not favor affiliated services nor disfavor rival services. In 1998, Drs. Stanley Besen and John Woodbury analyzed the then-largest cable operator's business practices with respect to the carriage of affiliated and unaffiliated video programmers.<sup>34</sup> Besen and Woodbury found that, "relative to its owned services," TCI, the largest cable MSO, "*actually favor[ed] non-affiliated services.*"<sup>35</sup>

#### **D. Evidence Of Increasing Programmer Leverage In Carriage Negotiations.**

It is likewise clear that these marketplace changes have given programmers substantial bargaining power in obtaining cable carriage agreements. As the Commission's annual video competition reports confirm, for example, the rates that video programmers charge cable companies have risen dramatically and consistently much faster than the rate of inflation. *See, e.g., 2000 Video Competition Report* ¶ 24 (noting that programming expenses rose 12.2% in 1999, and were projected to rise an additional 10.9% in 2000); *1999 Video Competition Report* ¶ 26 (reporting that programming costs increased 13.9% in 1998). Moreover, there have been a number of widely reported incidents that highlight the substantial leverage that video programmers have in carriage negotiations.

For example, as part of a recent retransmission consent dispute, Disney was able to obtain an agreement that Time Warner Cable would: (1) convert the Disney Channel from a premium to an expanded basic service; (2) significantly expand its current carriage of ESPN, ESPN2, ESPN Classic, and ESPN News; and (3) carry two new Disney services, SoapNet and Toon

---

<sup>34</sup> See Stanley M. Besen & John R. Woodbury, *An Economic Analysis of the FCC's Cable Ownership Restrictions*, MM Docket No. 92-264, App. A (filed Aug. 14, 1998) (attached as App. A to Comments of TCI) ("1998 Besen & Woodbury Report").

<sup>35</sup> *Id.* at A-23 (emphasis in original).

Disney.<sup>36</sup> At the same time, ESPN was notifying cable operators that “it would expand its lead as the most expensive national basic cable network and boost its license fees to operators by 20 percent.”<sup>37</sup> The increase was the third 20% price hike for ESPN in three years.<sup>38</sup> And Disney recently increased the price for ESPN by 20% for the fourth straight year.<sup>39</sup>

Similarly, in discussing Viacom’s ability to use its ownership of CBS to enhance its leverage in negotiating for carriage of Viacom programming on cable systems, Viacom President Mel Karmazin observed: “We have an awful lot now of retransmission to be able to take to Viacom and have Viacom use CBS retransmission content to get additional carriage for its properties. . . . The idea is that you should believe it is very good to be a broadcaster with cable [programming] assets.”<sup>40</sup> Lately, Viacom has begun to use this leverage by offering cable operators the choice of carrying Country Music Television or facing significant increases in the

---

<sup>36</sup> See Bruce Orwall & Joe Flint, *Disney, Time Warner Sign Deal*, Wall St. J., May 26, 2000, at B6.

<sup>37</sup> Steve McClellan & John Higgins, *Disney Triumphant*, Broad. & Cable, at 8 (May 8, 2000).

<sup>38</sup> See Rudy Martzke, *Rivals Might Fight for Rights Despite Unstable Economy, Some Networks Could Face Challenges*, USA Today, at C3 (June 29, 2001) (“ESPN is in the process of invoking its fourth annual 20% increase in rates to cable operators to pay for NFL games and other sports, bringing the price per home to \$1.40-\$1.60 a month. A portion of that fee will be passed along to subscribers.”).

<sup>39</sup> See Steve Donohue & R. Thomas Umstead, *ESPN 20% Fee Hike: Maximum Headache*, Multichannel News, May 7, 2001. See also R. Thomas Umstead, *Jordan Redux Could Boost NBA TV Rights*, Multichannel News, Oct. 1, 2001 (“Industry observers said an ESPN-NBA deal, which would give the network cable rights to all four major professional sports leagues, would significantly boost ESPN’s leverage. It would also provide ESPN with another high-profile product to justify its perennial 10-percent to 20-percent rate increases.”).

<sup>40</sup> Mike Farrell & Linda Moss, *Karmazin to Play Retrans Chip for MTVN Cable Networks*, Multichannel News, at 1, 66 (May 22, 2000).

price for the popular TNN service, which reaches over 80 million viewers.<sup>41</sup> Country Music Television has since grown from under 40 million households to 52 million households.<sup>42</sup>

Nor is the ability to secure cable carriage on favorable terms limited to media conglomerates such as Disney and Viacom. Any programmer that delivers quality content that is appealing to consumers has significant bargaining power in contract carriage negotiations.<sup>43</sup> The continued absence of program carriage complaints filed by video programming networks pursuant to 47 C.F.R. § 76.1300 *et seq.* further confirms the reality that programmers that have video content which is attractive to consumers can secure distribution arrangements with cable and non-cable outlets which allow them to remain viable and indeed prosper.

---

<sup>41</sup> See Linda Moss, *Viacom Leverages TNN to Ire of Small Ops*, TelecomClick (Apr. 13, 2001) (reporting that "Viacom's cable unit, MTV Networks, is floating a new rate card that bundles TNN, formerly The Nashville Network, and CMT together" and that "if a cable system doesn't opt to launch CMT, its monthly license fee for TNN will jump substantially, to as much as 50 cents") (<http://www.telecomclick.com/newsarticle.asp?Newsarticleid=194514&mode=print>).

<sup>42</sup> See Staci Kramer, *Viacom Reports Loss: Cable Business Boosted by Ad Gains Is a Bright Spot*, Cableworld, , at 35 (Oct. 29, 2001) (quoting Viacom President Mel Karmazin as saying, "[w]e also were experiencing a loss of distribution on CMT and we thought the leverage that would exist within Viacom would help that and CMT has gone from under 40 million to 52 million households as of today")

<sup>43</sup> See Ignazio Messina, *Time Warner Inks Pact with Oxygen and Nat Geo*, Multichannel News (Nov. 19, 2001) (reporting that Time Warner: (1) agreed to move the independent Oxygen network from a digital tier to a basic tier allowing the network to end the year with distribution in over 29 million households; and (2) announced a deal with the independent National Geographic Channel to launch the network to 80% of its 12.7 million customers over the next fourteen months).

**III. THE COMMISSION SHOULD APPLY WELL-ESTABLISHED ECONOMIC PRINCIPLES IN EXAMINING WHETHER CABLE CONCENTRATION WOULD CREATE A SERIOUS NON-CONJECTURAL RISK OF CABLE ABUSE OF BUYER MARKET POWER.**

The first step in applying the economically rigorous market power inquiry mandated by *Time Warner II* is to identify the relevant market, and, more pertinently, the relevant market participants that must be considered in assessing whether a large cable company would have both the incentive and ability to abuse buyer market power. See Declaration of Janusz A. Ordover ("Ordover Dec.") ¶¶ 15-18, 100 (attached hereto as Appendix A). These determinations "must encompass the realities of competition." See *Okasnen v. Page Memorial Hosp.*, 945 F.2d 696, 709 (4<sup>th</sup> Cir. 1991) (citing *United States v. Grinnell Corp.*, 384 U.S. 563, 572-73 (1966)).

The Commission next must identify the theories of anticompetitive harm that could *potentially* apply. Merely identifying a theory of potential harm does not, of course, mean that there is a serious real-world risk of such harm that might (if not outweighed by countervailing benefits) justify regulation. And, as *Time Warner II* makes clear, the First Amendment backdrop here precludes reliance upon conjecture or supposition that harm might occur.

The final step, therefore, is a rigorous examination of the real-world incentives and abilities of the large MSOs and programmers, as well as consumers and other market participants in order to determine whether the risk rises above mere theory or conjecture. This is the heart of the analysis, and it is highly dynamic. See Ordover Dec. ¶¶ 19-24. Thus, for each of the asserted potential theories of harm, the Commission must consider, *inter alia*, how video programmers would react if a cable company attempted the theorized conduct, how other buyers of programming and customers and competitors of the cable company would react, and the impact this real-world behavior would have on the cable company's incentives and ability successfully to engage in the conduct in the first place. This dynamic market power analysis can and should

be conducted on an industry-wide basis in this rulemaking proceeding, rather than on an *ad hoc* basis in future proceedings. As *Time Warner II* and sound economics dictate, a structural limit should be imposed only if it is demonstrated, on the basis of competent record evidence, that such a limit is necessary to prevent anticompetitive abuses of buyer market power by cable operators.

**A. The Relevant Video Programming Market Is Much Broader Than Merely The Carriage Of Video Programming Networks By MVPDs.**

As the *Notice* recognizes, in order to determine whether increased “concentration among cable operators” leads to “[e]xcessive bargaining power,” *Notice* ¶ 26, a reasoned analysis should begin with consideration of the relevant market, *id.* ¶¶ 9-17. Markets have both geographic and product contours. *United States v. Connecticut National Bank*, 418 U.S. 656, 660 (1974); *Brown Shoe Co. v. United States*, 370 U.S. 294, 324 (1962); *United States v. E. I. Du Pont De Nemours & Co.*, 353 U.S. 586, 593 (1957). Defining the geographic contours of the relevant video programming market is straight-forward. As the *Notice* (¶ 12) observes, the market for the sale and purchase of video programming is at least “national” because there are no significant costs of transporting programming. Precisely because transportation costs are not generally distance sensitive – video programming can be sent to virtually any distribution outlet in the world for roughly equivalent costs – the relevant market is actually international in scope. And although it was once the case that U.S.-produced content was marketed almost exclusively in North America, today international sales account for a very substantial portion of video programmers’ revenues. *See supra* Part II.

The *Notice* recognizes (¶¶ 9-13) that defining the product contours of the relevant video programming market is not as simple. Video programming is packaged and delivered to consumers in many forms and through many distribution channels. Consumers may “purchase”

and view video programming in a theater, sports bar or other public forum, on a home television that receives over-the-air broadcast signals or that is connected to cable, a satellite dish, or a DVD or videocassette player, and, increasingly, on a computer connected to the Internet. Producers of video programming may choose to license their products to any combination of retail distributors (e.g., firms that own broadcast TV stations, movie theaters, retail stores or video-streaming Internet sites) or “middlemen” (e.g., 24-hour programming “networks”) that package video programming in a variety of bundles for resale to cable, DBS, broadcast and other retail distributors. All of these firms compete, to one extent or another, to serve the same consumer demand for video programming.

Because the breadth and relative importance of the various purchasers of video programming can be influenced by the *type* of video programming, however, determining precisely what belongs in (and out of) a relevant video programming market that includes extraordinary content diversity can, at the margins, present exceedingly difficult economic questions. See Ordoover Dec. ¶ 108. For example, should a market that includes cable purchasers of video programming also include firms that license programming for DVDs and videocassettes (that are then sold or rented to consumers)? To producers of movies, DVD and videocassette distributors are as (or more) important than purchasers that deliver the programming over cable, DBS or alternative MVPD platforms. See *2000 Video Competition Report* ¶ 116 (“[t]he video retail industry is the largest source of revenues for movie studios, generating approximately \$11.8 billion in 1999, three times the revenue received from theatrical distribution”). And

emerging “video on demand” MVPD services obviously compete directly with DVD/videocassette rentals.<sup>44</sup>

Fortunately, precise delineation of the product contours of the relevant video programming market is unnecessary so long as the market power inquiry remains properly focused on whether cable operators could and would prevent video programmers from producing and delivering the content that consumers demand – and does not improperly veer into an arbitrary exercise in ensuring the survival of particular firms in one or another of the distribution chains. There simply is no public interest – and certainly no legitimate, competition-based interest as *Time Warner II* requires – in propping up particular types of program aggregators or ensuring that they receive carriage on cable. Ordover Dec. ¶ 112.

Thus, whether or not there is an economically significant “market” for “program packaging,” for example, see *Notice* ¶¶ 10-14, it is patent that no economically significant *market power* conclusions could be drawn from an analysis that looked *only* at cable and other MVPD purchasers of the particular bundles of video programming aggregated and marketed by HBO, CNN, MTV, the Golf Channel and other 24-hour programming networks. See *id.* ¶ 65. Cable dealings with 24-hour networks could harm social welfare only if they caused the number or quality of programs that are produced and distributed to consumers (by one means or another) to “fall below the competitive equilibrium.” Ordover Dec. ¶ 112; see also *Notice* ¶ 26 (proper

---

<sup>44</sup> See *2000 Video Competition Report* ¶ 114 (“[W]e consider home video sales and rentals part of the video marketplace because they provide services similar to the premium and pay-per-view offerings of MVPDs.”). On the other hand, dramatic television series generally are not widely distributed via DVD or videocassette (although there are exceptions, such as the *Sopranos*, which has topped DVD sales and rental charts). See, e.g., *Home Video*, *Star Ledger* (Feb. 16, 2001); *A Riveting, Bloody Civil War Tale Feed Your Machines; What’s Worth Your Time In VIDEO And MUSIC Releases – And On The WEB*, *The Atlanta Constitution*, at C4 (Feb. 8, 2001) (2001 WL 3658829).

concern is market power abuses that “could enable cable operators to reduce unduly the economic returns of programmers, causing them to curtail their activities and thereby limit the quality and diversity of programming fare”). The potential for such harm to programming production and distribution is directly affected by the availability of (and terms offered by) *all* potential purchasers of that programming, and not simply the terms that MVPDs offer to program producers and/or aggregators that may purchase and resell the programming. That is because a seller’s susceptibility to victimization by a large buyer turns, in large part, on the seller’s distribution alternatives.<sup>45</sup> A producer of video programming would consider *all* of its alternative sources of distribution and revenue – whether this revenue is derived from sales to MVPDs or other non-MVPD channels – before folding its tent or knuckling under to an anticompetitive threat by a cable operator. Ordoover Dec. ¶¶ 15, 18. Similarly, as explained below, a cable operator would likewise consider the programmers’ alternatives, as well as the potential adverse effect of denying its customers access to programmers they desire, before making any such threat. *Id.* ¶¶ 21-22.

Thus, although it may be impossible to reach consensus on the outer boundaries of the relevant product market, some non-MVPD purchasers plainly must be included. There can be no question, for example, that broadcast networks must be included among the relevant market participants. Although program packagers may focus on cable, DBS and other MVPD distribution outlets for their services, studios sell many of the shows that they develop to broadcast TV stations which are generally viewable by customers that do not have cable – and, because of must-carry rules (and, in many cases, by consumer demand), by cable subscribers as

---

<sup>45</sup> See, e.g., *Permian Basin Area Rate Cases*, 390 U.S. 747, 795 n.64 (1968); *United States v. Syufy Enterprises*, 903 F.2d 659, 666 (9<sup>th</sup> Cir. 1990).

well. Ordoover Dec. ¶¶ 109-110.<sup>46</sup> Indeed, the Commission has already recognized that “[b]roadcast networks and stations are competitors to MVPDs in the advertising and program acquisition markets.” *2000 Video Competition Report*, ¶ 14; *see also* Report and Order, *Amendment of Section 73.658(g) of the Commission's Rules - The Dual Network Rule*, 16 FCC Rcd. 11114, ¶ 36 (2001) (“*Dual Network Rule Order*”) (eliminating the “dual network” rule because the emergence of alternative video delivery systems subjected established broadcast networks to increasingly vigorous competition). Broadcast television networks are particularly important outlets for programmers because, although fewer in number than cable channels, they attract much larger audiences, *Dual Network Rule Order* ¶ 20 & n.46; *2000 Video Competition Report* ¶ 99, and generate much higher advertising revenues, *id.* ¶ 98 (advertising revenue for the seven broadcast networks (ABC, CBS, Fox, NBC, PaxTV, UPN and WB) “alone reached \$18 billion in 1999”; “[i]n comparison, cable programming networks earned \$8.3 billion in advertising revenue”).

Proper recognition that the relevant market participants extend well beyond MVPD purchasers of video programming does not mean that the Commission necessarily must consider exhaustive data and conduct extensive analyses on all possible purchasers of video programming. As demonstrated below, even when the inquiry is artificially limited to only U.S. MVPD purchasers, no serious, non-conjectural risk of consumer harm from cable abuse of buyer market power can be demonstrated.

---

<sup>46</sup> Broadcast TV stations are also being increasingly carried by DBS providers. And as of the first of this year, a DBS provider that offers a local channel in a market must offer all local channels in that market.

**B. The Market Power Analysis Must Reflect The Dynamic Effects Of Retail Competition And Other Real-World Constraints On The Incentives And Behavior Of Sellers And Purchasers Of Video Programming.**

*Time Warner II* makes clear that any “assessment of a real risk of anticompetitive behavior” must take account of the “availability” of competition and the extent to which that competition constrains a cable owner’s ability to exercise market power. 240 F.3d at 1134. As the *Notice* repeatedly recognizes (§§ 6, 26, 44), this is necessarily a “dynamic” analysis and therefore the Commission must consider how consumers and other purchasers of video programming would respond to cable company conduct, and the effect those responses would have both on programmers’ susceptibility to victimization and the cable company’s incentive to engage in anticompetitive conduct in the first place.

To illustrate, suppose that a cable company refused to carry Showtime in order to favor Starz!. A static approach would consider only the existing market share of DBS and other MVPDs in determining whether Showtime could remain viable and maintain quality programming. A properly dynamic approach, however, would recognize that DBS operators and other distributors that compete directly with the cable company would have every incentive to target customers of the cable company and highlight that they carry Showtime. Many existing and future cable subscribers would switch to DBS or other alternative providers; others would simply drop cable (or not subscribe in the first place) and instead view broadcast TV or videocassette/DVD movies. The resulting flow of subscribers and money from the cable company to other distribution outlets would both increase the other distributors’ willingness to pay for Showtime and the number of viewers Showtime would reach through these non-cable outlets. All of these sophisticated actors would be fully aware that these things would happen,

which, of course, impacts the incentives of the cable company to attempt the conduct in the first place (and the credibility of any threat to do so).

Thus, the existence of substantial competition (even still-developing competition) at the retail level is highly relevant to determining whether the abuse of buyer market power that proponents of cable ownership concentration limits predict is at all likely or realistic. In this regard, it is now well past time for the Commission definitively to lay to rest the claim that DBS and cable are not close substitutes. As detailed above, "DBS has a national footprint," *Notice* ¶ 22, and the capacity and ability to serve virtually every cable consumer in the U.S. Most DBS subscribers are former cable subscribers, and DirecTV and EchoStar concede that they price their services "with the objective . . . to gain market share by luring away consumers from the leading cable providers."<sup>47</sup>

The obvious and close substitutability of cable and DBS is further confirmed by empirical evidence. For example, in its recent *Report on Cable Industry Prices*, the Commission undertook a regression analysis of the effects of DBS on the demand for cable services and concluded that "DBS is a substitute for cable service."<sup>48</sup> Likewise, according to even relatively stale data collected by Professors Austan Goolsbee & Amil Petrin,<sup>49</sup> between 26 and 40 percent

---

<sup>47</sup> Declaration of Robert Willig, *Consolidated Application of EchoStar Communications Corp., General Motors Corp., and Hughes Electronics Corp. for Authority To Transfer Control*, CS Docket No. 01-348, ¶ 10 (filed Dec. 3, 2001) ("Willig EchoStar-DirecTV Merger Dec."). According to the DBS operators, "the companies collect detailed data on cable pricing of many systems and, as necessary, adjust their pricing to remain competitive on a national basis." *Id.*

<sup>48</sup> *Report on Cable Industry Prices, Implementation of Section 2 of the Cable Television Consumer Protection and Competition Act of 1992*, 16 FCC Rcd. 4346, ¶ 53 (2001) ("Report on Cable Industry Prices").

<sup>49</sup> *The Consumer Gains from Direct Broadcast Satellites and the Competition with Cable TV*, University of Chicago Graduate School of Business Working Paper (October 2001).

of basic cable customers who leave cable in response to an increase in cable prices would choose DBS instead. As Professor Ordoover explains (§ 118), these “diversion” ratios are very high and show that, even compared to other markets considered highly competitive, cable systems that raise their prices (or degrade quality) would suffer enormous losses to DBS. And the Goolsbee/Petrin data predate both the recent passage of SHVIA, which finally brought widespread carriage of local broadcast signals to DBS, *see 2000 Video Competition Report* §§ 68-71, recent targeted marketing initiatives launched by DBS operators, and the now commonplace DBS offers that include no upfront charges, and thus plainly understate the extremely high cross-elasticity between cable and DBS.

Even in the wake of this overwhelming evidence that cable and DBS are close substitutes, proponents of additional regulation will claim that strict subscriber limits will be necessary so long as cable maintains a significant static market share lead over DBS. But that is the very mistake that led to the remand in *Time Warner II*. A cable company’s incentive and ability to engage in anticompetitive conduct that, by definition, degrades the quality of its programming is determined not by the number of subscribers the cable company has before it engages in the strategy, but by the number of subscribers it is likely to have *after* it does so.<sup>50</sup> Thus, as explained in detail below, the required market power analysis must focus on the long-term competitive consequences to the cable company of the claimed theories of competitive harm, and not on any static snapshot. *See Notice* § 50 (“the availability of an alternative MVPD

---

<sup>50</sup> To the extent static market shares could be relevant at all, the only conceivably meaningful comparison would be *digital* subscribers, *see Ordoover Dec.* §§ 23, 55. DBS *leads* cable by that measure. *See Karim Zia et al.*, Deutsche Bank Alex. Brown, *Cable Industry Outlook*, at 49 (Sep. 6, 2001).

outlet affords programmers access and consumers choice, and erodes cable's or an MSO's market power irrespective of current market shares").

The retail dynamics are highly relevant in another respect as well. Carriage contracts are multi-year contracts (often with primary terms of a decade or more). In considering carriage offers and alternatives, video programmers must therefore focus not on a distributor's *current* subscribership, but on the distributor's *expected* number of subscribers over the life of the multi-year contract. See Ordoover Dec. ¶ 104. A cable operator that engages in anticompetitive conduct that makes its offerings less attractive to consumers will lose customers to non-cable distributors. As a result, these alternative distribution channels become more valuable to programmers. *Id.* In other words, a DBS provider with 10 million subscribers today that is expected to have 15 million subscribers 5 years into the contract might instead be expected to have 20 million subscribers in the wake of self-destructive cable misbehavior. It is this type of dynamic analysis that is required by *Time Warner II* and sound economics.

Although it is essential that the Commission consider the dynamic effects of retail competition, it must maintain the proper focus on buyer market power over programmers and the impact that consumers' non-cable alternatives have on *that* question. It is thus wholly irrelevant whether a cable company could exercise *retail* market power over consumers in any particular local market. Even if one could establish that a cable company had market power over consumers in one or more localities – and that would be no easy matter given the competitive pressures imposed by DBS and other alternative MVPDs<sup>51</sup> – that still could not justify national

---

<sup>51</sup> The indicia of market failure Chairman Powell identified in 1998 – whether cable operators are (1) imposing non-cost-based price increases; (2) restricting output; and (3) refraining from innovating – plainly are not present. See Fifth Annual Report, *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 13 FCC Rcd. 24284, 24485-86 (1998) (Separate Statement of Commissioner Powell) (“1998 Video Competition (continued . . .)”).

subscriber limits. As the *Notice* recognizes (§ 19), the “geographic scope of . . . [the] market” for retail distribution of video-programming by MVPDs is “local.” Thus, any power that a cable MSO has over *consumers* in a particular community comes not from how many other communities and subscribers that MSO’s systems serve, but from the fact that subscribers in that discrete geographic area lack effective alternatives to the MSO’s services. Ordoover Dec. §§ 12, 15. A tiny MSO that (counterfactually, given the nationwide presence of DBS) faced no retail competition might have power over its few retail customers without any conceivable ability to harm programmers.

**C. Real-World Constraints In the Highly Dynamic Video Programming Marketplace Call Into Question Whether A Subscriber Limit Can Be Justified By Any Of The Posited Theories Of Competitive Harm.**

The *Notice* thoroughly catalogues the disparate theories of competitive harm that have been advanced by proponents of subscriber limits on cable ownership concentration. See *Notice* §§ 28-35. *Time Warner II* makes clear, however, that any specific subscriber limit on cable ownership concentration could be economically rational and survive First Amendment scrutiny only if it was shown that there is a serious and non-conjectural risk that the theorized competitive harm would actually occur in the real-world in the absence of that limit.

---

(. . . continued)

*Report*). First, cable operators have not disproportionately increased the price of their service in comparison to the dramatic rise in their costs. See *2000 Video Competition Report* §§ 24, 33. Second, rather than restricting output, cable operators have invested billions in upgrading their facilities and in creating or acquiring new programming, thereby increasing the number of channels, programs, and services available to consumers. See *id.* §§ 9, 20-21. Third, cable operators are among the leaders in high technology innovation, and are now providing customers with a variety of innovative new digital services, including digital video, cable Internet service, and cable telephony. Indeed, the Commission has already ruled that cable systems serving hundreds of communities are subject to effective competition.

Several of the theories advanced in the *Notice* fail at the outset, because, in direct contravention of both *Time Warner II* and sound economics, they are entirely unrelated to the relevant governmental interest in preventing abuses of market power against video programmers. Thus, for example, the *Notice* inquires whether increased ownership concentration might interfere with local regulators' ability to "benchmark" one cable company against others. See *Notice* ¶ 32 ("It is possible that the existence of multiple MSOs provide [local franchising authorities (LFAs)] with alternatives at least as a means to compare the performance of the incumbent against other operators . . . . If so, then the existence of multiple MSOs could provide a helpful check on MSO practices in their franchise area"). But Congress expressly prohibited LFAs from considering an MSO's "mix and quality" of programming when considering renewal, 47 U.S.C. § 546(c)(1)(B). Benchmarking, to the extent it occurs at all, is therefore limited to financial and performance issues (*e.g.*, signal quality and customer service) that are unrelated to differences in the relative levels of cable ownership concentration. Thus, any "benchmarking" interest in this context cannot be linked to video programming at all, much less to the specific video programming *market power* interest that must be furthered by any ownership concentration limit. A "benchmarking"-based subscriber limit would therefore necessarily meet the same fate as the "more is better" diversity rationale rejected in *Time Warner II*.<sup>52</sup>

---

<sup>52</sup> In all events, it is far from clear that "benchmarking" could be shown to advance materially even its stated goal of helping LFAs obtain the most favorable financial and performance terms. Because of the competitive threat of DBS and other alternative MVPDs, franchised cable systems already have strong incentives to provide good customer service and signal quality independent of the franchise renewal process. Ordover Dec. ¶ 87. Sunk investment by MSOs and competition for franchises likewise already provides LFAs with ample bargaining power, as confirmed by the public access studios, institutional networks, and free municipal cable hook-ups that LFAs routinely and successfully demand. *Id.* ¶ 88.

The *Notice* also inquires whether increases in cable ownership concentration might change the remaining MSOs' incentives with respect to innovation, program diversity and retail pricing. *Notice* ¶¶ 31, 35. The *Notice* points out (¶ 31), for example, that "[s]ome economists argue that monopolists are insufficiently motivated to minimize costs and to innovate, and therefore incur 'X-inefficiencies.'" Similarly, "[s]ome economists have argued that a monopoly MVPD would provide fewer choices among similar types of programming and charge higher prices for that programming than competitive MVPDs." *Id.* ¶ 35. But the *Notice* improperly conflates the relevant inquiry of cable market power over *programmers* with concerns related solely to *retail* monopoly power over consumers. As demonstrated above and in Professor Ordover's declaration, changes in ownership concentration – that is, changes in the number of discrete local cable systems that the largest MSOs own – simply have no effect on an MSO's retail power (or lack thereof) over consumers in any particular locality. Thus, even if economists could agree that innovation and quality would suffer in the face of a cable system retail monopoly, that could not support a limit on the number of local cable systems that an MSO can own. See Ordover Dec. ¶¶ 89-90.

The three remaining economic theories identified in the *Notice* – monopsony, "hold-up" of sunk programming investment, and foreclosure – are at least logically related to national size and must, therefore, be thoroughly analyzed through a dynamic economic lens. As demonstrated below, although each is a recognized theory of economic harm that can, in some contexts, justify buyer market power-based regulation, none of the three gives rise to any serious, non-conjectural risk in this context, given the real-world constraints and dynamics that exist in the video programming marketplace.

**1. Monopsony Power is not a Realistic Concern in this Context.**

The *Notice* (§ 28) inquires whether an MSO of sufficient size “might be able to determine the success or failure of a programming network,” or otherwise make anticompetitive carriage decisions – either declining to carry a network or demanding non-compensatory terms that might cause the network to exit or reduce quality – that a firm without such “monopsony power” would not make. Although the theoretical applicability of this traditional monopsony theory to this context has largely gone unchallenged in past proceedings,<sup>53</sup> the defining characteristics of video programming, in fact, render the theory inapplicable.

Traditional monopsony theory holds that a firm that buys a sufficiently high percentage of the output of a group of sellers may have the ability unilaterally to set the price it pays for goods or services produced by the sellers. Richard Pindyck & Daniel Rubinfeld, *Microeconomics* 356-59 (1989). If the monopsonist demands a lower (than the competitive market equilibrium) price from the sellers, that, in turn, may cause the sellers to reduce the amount of the good or service they produce. Because it is usually the case that the monopsonist’s own output is tied to the amount of the inputs it purchases, the exercise of market power in this way generally reduces the monopsonist’s output as well. A profit-maximizing monopsonist may nonetheless have an incentive to insist on the lower, output-reducing price, because the monopsonist’s *marginal* cost of an additional unit of the input may be higher than the marginal cost to a non-monopsonist that is a price taker, rather than a price setter. As Professor Ordover explains by way of example:

---

<sup>53</sup> See, e.g., 1999 *Horizontal Order* §§ 13, 32; Notice of Proposed Rulemaking, *Implementation of Sections 11 and 13 of the Cable Television Consumer Protection and Competition Act of 1992 Horizontal and Vertical Ownership Limits*, 8 FCC Rec. 210, § 31 (1992).

Suppose that two hospitals, which draw on the same labor pool but compete in different output markets, are each willing to pay up to \$33K for a nurse. Assume that there are two nurses available willing to work for \$25K and for \$30K, respectively, and that each is of equal ability. The equilibrium market price for nurses is then \$30K. Each hospital will hire one nurse, because the marginal benefit of hiring the nurse (\$33K) is greater than the marginal cost (\$30K).

Suppose the two hospitals merge and that the combined company becomes a price setter in the input market. Then the merged firm can hire one nurse for \$25K, or two nurses for \$30K each. Critically, the marginal cost of a second nurse is not \$30K, but rather \$35K (the \$60K cost of two nurses minus the \$25 K cost of one nurse). In essence, the marginal cost of the second nurse rises above the supply curve, and the monopsonist responds by hiring fewer nurses. Thus, in my example, the merged hospital will hire only one nurse instead of two, even though the marginal benefit of hiring the second nurse (\$33K) is higher than the price for which she is willing to work (\$30K).

Ordover Dec. ¶¶ 68-69. In these circumstances, a “monopsony buyer that resells in a competitive market will charge the same price, but its output will be lower than if it were a competitive purchaser.” Herbert Hovenkamp, *Federal Antitrust Policy* § 1.2b (1994). “The important policy implication of monopsony power is that it *reduces* rather than increases output.” *Id.*

The economic literature documenting the ability of companies to exercise this type of monopsony power was developed in the context of “rivalrous” goods – *i.e.*, a good that when sold to one buyer cannot be sold to another buyer. Ordover Dec. ¶ 66. And, as the *Notice* recognizes (¶ 15), programming is not a rivalrous good: “[c]onsumption of the programming of a video programming network . . . by one viewer does not reduce the amount of the good available for another viewer.” This critical aspect of the “market structure” negates the normal intuition that a very large purchaser may be able to exercise monopsony power over sellers.

Put simply, an MVPD monopsonist that is a price setter would choose the same bundle of programming as a competitive purchaser. Ordover Dec. ¶ 67. That is because where, as here,

the “goods” in question are non-rivalrous, the monopsonist’s marginal cost of purchasing an additional unit does *not* materially differ from the non-monopsonist’s marginal cost:

[A]ssume that there are two different MSOs in different local retail markets and that programming available from either of two suppliers is worth \$33K to each MSO. As above, assume equal quality of programming, and that each MSO has one channel slot to fill. Also, as above, assume one programmer is willing to sell to each MSO for \$25K, and the other for \$30K (and, therefore, the programmers need to make in toto \$50K and \$60K, respectively, in order to cover their costs). If each MSO is a “price taker,” then both will purchase the cheaper program at a price of slightly below \$30K (say \$29K). If the two MSOs merge, then the merged entity will still purchase the same program that would have been purchased by the stand alone MSOs.

Ordover Dec. ¶ 70. For that reason, a profit-maximizing cable “monopsonist” – an entity which, it should be noted, could exist only in a counterfactual hypothetical world, given that in the real-world video programming suppliers have many non-cable distribution alternatives – would purchase the exact same amount of programming as the non-monopsonist. *Id.* ¶ 72.<sup>54</sup>

Furthermore, although the hypothetical cable monopsonist might have the *ability* to insist on a price so low (below \$25K in the above example) that the programmer would be forced either to fold its tent or reduce quality, the monopsonist plainly would have no *incentive* to do so. An MSO’s demand for program quantity and quality is determined by consumer demand and *retail* competition that are independent of, and would be unchanged by, the acquisition of monopsony power over programmers. *Id.* ¶¶ 71-72, 74-75. Regardless of its size relative to other programming buyers, a cable MSO wants programmers to produce and sell to it the programming that is likely to produce the greatest number of viewers relative to the cost of the

---

<sup>54</sup> Moreover, as Professor Ordover explains, the traditional monopsony story breaks down for an additional, independent reason. Because a monopsonist cable MSO could price discriminate – paying programmers differing prices depending upon each individual programmer’s minimum reserve price, or willingness to produce, the monopsonist’s marginal cost would not differ from the non-monopsonist’s marginal cost even if programming was a rivalrous good. *See* Ordover Dec. ¶ 73.